

REPORT OF EXAMINATION
OF THE
HSA HOME WARRANTY COMPANY
AS OF
DECEMBER 31, 2010

Filed September 29, 2011

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Los Angeles, California
August 12, 2011

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

HSA HOME WARRANTY COMPANY

(hereinafter also referred to as the Company) at the Company's main executive office and the primary location of its books and records, 1861 Ludden Drive, Cross Plains, Wisconsin 53528. The statutory home office is located at 6939 Sunrise Boulevard, Suite 120, Citrus Heights, California 95610.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2006. This examination covers the period from January 1, 2007 through December 31, 2010. The examination was conducted in accordance with the National Association of Insurance Commissioners' Financial Condition Examiners' Handbook. The Handbook requires the planning and performance of the examination to evaluate the Company's financial condition, to identify prospective risks, and to obtain information about the Company, including corporate governance, identification and assessment of inherent risks, and the evaluation of the system controls and procedures used to mitigate those risks. The examination also included an assessment of the principles used and the significant estimates made by management, as well as an evaluation of the overall financial statement presentation, and management's compliance with Statutory Accounting Principles and Annual

Statement instructions. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; pensions, stock ownership and insurance plans; growth of company; accounts and records; and statutory deposits.

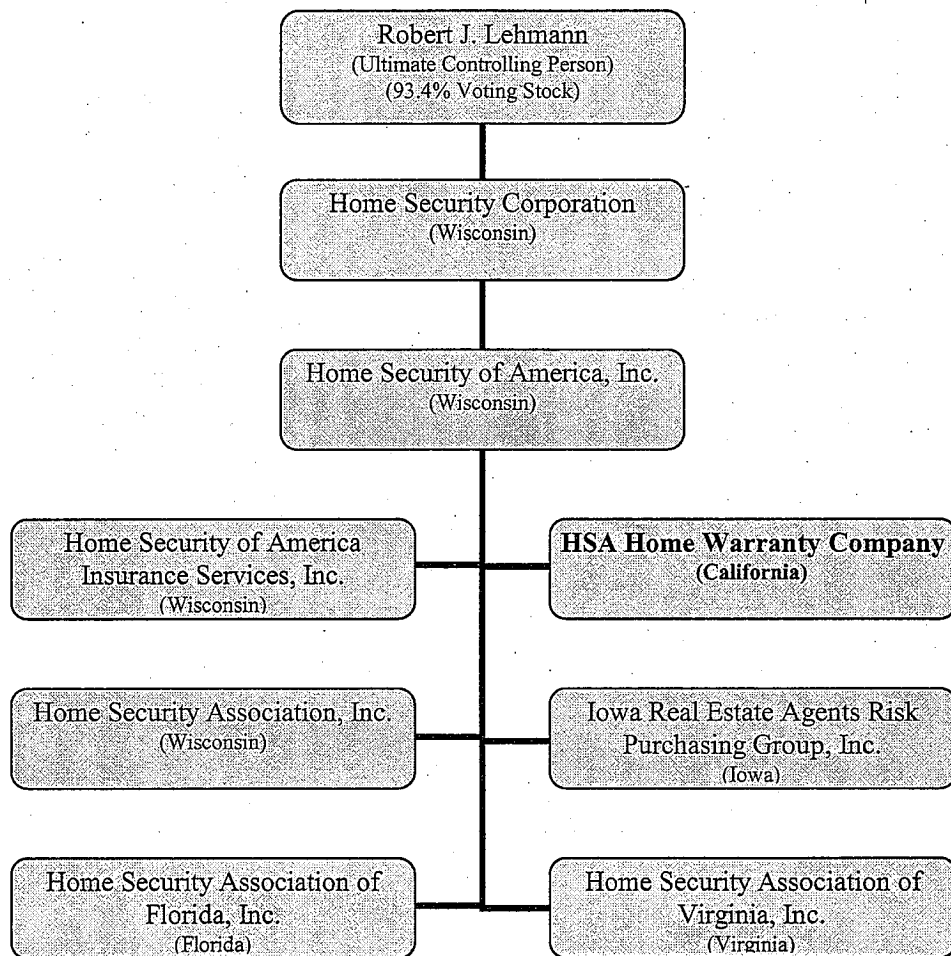
COMPANY HISTORY

The Company was incorporated in the State of California on February 24, 1999, and commenced transacting home protection business in 2007. All outstanding shares of the Company are owned by its parent, Home Security of America, Inc. (HSAI), a Wisconsin Company. In turn, HSAI is wholly owned by a Wisconsin domiciled holding company, Home Security Corporation (HSC). The ultimate controlling person is Mr. Robert J. Lehmann, a stockholder owning 93.4 percent of the HSC voting stock.

During the examination period, there were several stock option transactions exercised by the stockholders of HSC; however pre-approval by the California Department of Insurance was not necessary as none of the transactions involved stockholders that owned 10 percent or more of HSC, and Mr. Robert J. Lehmann remained the majority controlling stockholder of HSC. The Company disclosed these transactions within its Annual Registration Statement Form B and Form C filings.

MANAGEMENT AND CONTROL

The Company is a member of a holding company system of which Mr. Robert J. Lehmann is the ultimate controlling person. The following abridged organizational chart depicts the Company's relationship within the holding Company system: (all ownership is 100%; unless otherwise noted).



Management of the Company is vested in a three-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2010 is as follows:

Directors

Name and Residence

Principal Business Affiliation

Steven P. Dedo
Deerfield, Wisconsin

Treasurer, Secretary, and Chief Financial
Officer
HSA Home Warranty Company

David R. Lehmann
Middleton, Wisconsin

Vice President Sales
HSA Home Warranty Company

Robert J. Lehmann (*)
Verona, Wisconsin

Director, President, and Chief Executive
Officer
HSA Home Warranty Company

Principal Officers

Name

Title

Robert J. Lehmann (*)
Steven P. Dedo

Director, President, and Chief Executive Officer
Treasurer, Secretary, and Chief Financial Officer

(*) Resigned as President and named Chief Executive Officer of the Company on January 25, 2007. Mr. Michael F. Clear named President of the Company on January 25, 2007; Mr. Michael F. Clear resigned as President on September 1, 2009, and was replaced by former President, Mr. Robert J. Lehmann.

Management Agreements

Management Services Agreement: Effective September 12, 2005, the Company entered into a management service agreement with its parent, Home Security of America, Inc., (HSAI). Under the terms of the agreement, HSAI provides the Company with legal, accounting, marketing, administrative, underwriting, investment, computer programming, personnel, and other management services, on an actual cost basis. For the 2007, 2008, 2009, and 2010 years, the Company accrued (\$458), \$1,337, \$1,080, and \$129,140 respectively, for services received under the terms of the agreement. The California Department of Insurance (CDI) approved this agreement on July 8, 2005.

Claims Services Agreement: On September 1, 2004, the Company entered into a claims service agreement with Buyers Home Warranty Company (BHWI). Under the terms of the agreement,

BHWC would provide the Company with claims services. The effective date of the agreement was amended to coincide with the first submission by the Company to BHWC to administer claims. The amendment was approved by the CDI on July 23, 2007. However, no claims were ever submitted to BHWC for administration and instead the Company effectively terminated this claims services agreement with BHWC. Since July 23, 2007, the Company's claims services have been provided by its parent, HSAI, as defined by services determined to be reasonably necessary in the conduct of its operations within the aforementioned Management Services Agreement.

Tax Sharing/Tax Consolidation Agreement: Effective September 12, 2005, the Company entered into a tax sharing consolidation agreement with Home Security Corporation (HSC). Under the terms of the agreement and for federal income tax purposes, the Company is a qualifying Subchapter S subsidiary of HSC. Therefore, HSC assumes and pays all federal income tax liabilities incurred by the Company, and HSC does not charge-back or otherwise seek reimbursement from the Company for the federal income taxes that it assumes and pays on its behalf. In reference to premium taxes, the Company pays its own premium taxes imposed under the provisions of the California Revenue and Taxation Code. The CDI approved this agreement on July 8, 2005.

CORPORATE RECORDS

Pursuant to California Insurance Code (CIC) Section 735, the Company is required to inform the board members of the receipt of the examination report; both in the form first formally prepared by the examiners, and in the form officially filed by the Commissioner, and document these facts within the board minutes. A review of the board minutes disclosed that the Company did not make the required reference.

Pursuant to CIC Section 1200, the Company is required to disclose the authorization and approval of its investments within its minutes. In addition, CIC Section 1201 requires that the entry of approval documented within the minutes include specific references to amounts, facts, names of approving directors, and the value of the securities. A review of the Company's minutes disclosed that the Company failed to adhere to the reporting requirements of CIC Sections 1200 and 1201.

It is recommended that the Company implement procedures to ensure compliance with the provisions of CIC Sections 735, 1200, and 1201.

TERRITORY AND PLAN OF OPERATION

As of December 2010, the Company was licensed to transact home protection insurance solely in the State of California, and focuses mostly on selling residential mechanical warranty contracts to homeowners. Under the terms of these contracts, the Company warrants the operation of appliances, heating and air conditioning systems, and other consumer residential equipment, and contract coverage periods are typically 12 months in duration.

The Company utilizes sales representatives, employed by its parent company, to produce its business. These sales representatives reside in California, and establish relationships with real estate brokers to market and sell the Company's home protection business. In 2010, the Company wrote \$107,219 in home protection insurance and currently, there are approximately 753 contract holders.

LOSS EXPERIENCE

A review of the Company's loss experience during the examination period, disclosed a historical trend of net underwriting losses and net losses as follows:

Year	Net Underwriting (Loss)	Net Income or (Loss)	Company Surplus
2007	\$ (19,692)	\$ 16,568	\$ 869,882
2008	(28,265)	(12,733)	853,940
2009	(22,874)	10,176	867,152
2010	(184,878)	(177,743)	686,405
2011(*)	(52,289)	(51,028)	632,872

(*) Through March 31, 2011

The Company disclosed that its unfavorable loss experience trends can be attributed to high startup costs; acquisition costs; other underwriting expenses; the slowdown of the real estate market; and the inability to produce an adequate premium volume. In an attempt to remedy the loss experience

trends, the Company has implemented strategic changes in 2011, such as, reducing the number of its field sales representatives, paying lower claims expense transaction fees with the implementation of a new claims system, and generating more business through the residential real estate market. Utilizing these strategic plans, the Company is forecasting a return to profitability in 2012.

REINSURANCE

The Company did not assume or cede any reinsurance during the examination period.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2010

Underwriting and Investment Exhibit for the Year Ended December 31, 2010

Reconciliation of Surplus as Regards Contract Holders from December 31, 2006
through December 31, 2010

Statement of Financial Condition
As of December 31, 2010

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Cash and short term investments	\$ 863,267	\$	\$ 863,267	
Service fees receivable	10,916	3,176	7,740	
Interest, dividends and real estate income due and accrued	99		99	
Total assets	<u>\$ 874,282</u>	<u>\$ 3,176</u>	<u>\$ 871,106</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Claims adjusted and unpaid or in process of adjustments			\$ 7,029	(1)
Claims service expenses			2,229	
Other expenses			874	
Taxes, licenses and fees			2,541	
Unearned home protection contract fees			42,888	
Payable to parent, subsidiaries and affiliates			<u>129,140</u>	(2)
Total liabilities			184,701	
Common capital stock		\$ 50,000		
Gross paid-in and contributed surplus		750,000		
Unassigned funds (surplus)		<u>(113,595)</u>		
Surplus as regards contract holders			<u>686,405</u>	
Total liabilities, surplus and other funds			<u>\$ 871,106</u>	

Underwriting and Investment Exhibit
For the Year Ended December 31, 2010

Statement of Income

Underwriting Income

Home protection contract fees earned		\$ 65,133
Deductions:		
Claims incurred	\$ 22,567	
Claims service expense incurred	3,663	
Other underwriting expenses incurred	<u>223,781</u>	
Total underwriting deductions		<u>250,011</u>
Net underwriting loss		(184,878)

Investment Income

Net investment income earned	\$ <u>7,135</u>	
Net investment gain		<u>7,135</u>
Net loss		<u><u>\$ (177,743)</u></u>

Capital and Surplus Account

Surplus as regards contract holders, December 31, 2009		\$ 867,152
Net loss	\$ (177,743)	
Change in nonadmitted assets	<u>(3,004)</u>	
Change in surplus as regards contract holders for the year		<u>(180,747)</u>
Surplus as regards contract holders, December 31, 2010		<u><u>\$ 686,405</u></u>

Reconciliation of Surplus as Regards Contract Holders
from December 31, 2006 through December 31, 2010

Surplus as regards contract holders, December 31, 2006, per Examination		\$ 853,314
	Loss in <u>Surplus</u>	
Net loss	\$ 163,733	
Change in nonadmitted assets	<u>3,176</u>	
Total losses	\$ <u>166,909</u>	
Net decrease in surplus as regards contract holders		<u>(166,909)</u>
Surplus as regards contract holders, December 31, 2010, per Examination		<u>\$ 686,405</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Claims Adjusted and Unpaid or in Process of Adjustment

Based on a review of claim payments and reserves subsequent to the examination date, the reserves for the above captioned account appear to be reasonable and have been accepted for purposes of this examination.

(2) Payable to Parent, Subsidiaries and Affiliates

This account balance consists of intercompany transactions payable by the Company to its parent, Home Security of America, Inc. (HSAI), for services that HSAI provided to the Company under the previously discussed Management Services Agreement. These payables are not being settled in a timely manner, as required by the provisions of its Management Services Agreement (Agreement), and pursuant to the Statements of Statutory Accounting Principles (SSAP) numbers 25 and 96. HSAI granted the Company the settlement option delay predicated on the Company's noted adverse loss experience previously discussed within this report. In addition, HSAI does not expect the Company to settle the payable balances until it becomes profitable. These settlement options are not included within the terms of the Agreement. Therefore, it is recommended that the Company settle its intercompany transactions in a timely manner, in accordance with the provisions of its Management Services Agreement, and SSAP numbers 25 and 96.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Corporate Records (Page 5): It is recommended that the Company implement procedures to ensure future compliance with California Insurance Code Sections 735, 1200, and 1201.

Payable to Parent, Subsidiaries, and Affiliates (Page 11): It is recommended that the Company settle its intercompany transactions in a timely manner, and in accordance with the provisions of its Management Services Agreement, and Statements of Statutory Accounting Principles numbers 25 and 96.

Previous Report of Examination

None.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

/S/

Bridget Lopez, CFE,
Examiner-In-Charge
Department of Insurance
State of California